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TELECOPY COVER SHEET

DATE: 11-5-97.

TO: David Guzy

FROM: Peter Velez

SUBJECT: Comments

5 PAGES INCLUDING COVER SHEET

IF YOU HAVE ANY TROUBLE, PLEASE CALL Benita Dale AT (504) 588-8002

REMARKS:

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Exploration and Production
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November 5, 1997

VIA FAX AND AIRBORNE EXPRESS

Mr. David S. Guzy
Chief, Rules and Publications Staff
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Dear Mr. Guzy:

RE: SHELL OFFSHORE INC. COMMENTS ON ALTERNATIVES FOR ESTABLISHING OIL VALUE FOR PRODUCTION ON FEDERAL LEASES 62 FR 49460 (SEPTEMBER 22, 1997)

These comments are filed on behalf of Shell Offshore Inc. and its affiliates, Shell Deepwater Development Inc., Shell Deepwater Production Inc., and Shell Western E&P Inc., hereinafter collectively referred to for purposes of these comments as "Shell".

On two prior occasions, Shell has filed comments on MMS rulemaking proposals. The first was on the original January 24, 1997 MMS oil valuation proposal, and the second was on the July 3, 1997 amendment of that proposal. The January 24, 1997 MMS proposal was very detailed and as a result Shell was able to file extensive comments on it. Extensive industry comments were also filed on various trade organizations and other producers on this January 1997 proposal. However, MMS has yet to adequately respond to these comments. The three columns of the September 22, 1997 Federal Register notice which purport to summarize all industry comments on the original January 1997 proposal were both discouraging and disconcerting in light of the huge investment of time put into formulating the comments by various producers and trade organizations.

MMS in this latest notice of September 22, 1997 has identified two valuation alternatives, one of which has a benchmark concept, both of which are to be used to determine value. A second series of one line methods is also suggested for determining location differentials. No detail on how these one line location differential concepts would work were provided. Frankly, the proposal in the Federal Register is so sketchy and lacking in detail that its value as a mechanism for comment from the public for future regulation is highly questionable, both from a practical point of view, as well as under the minimum requirements of the Administrative Procedure Act. In furtherance of this notice, the MMS subsequently published on September 26, 1997 a notice of public workshops to be held in various locations all around the country to solicit further comments on these valuation alternatives. The notice given for the workshop was so short (less than five work days notice) that it provided inadequate time to schedule meaningful participation by either oil companies or trade organizations. Some companies were not even able to attend due to the short notice. Large trade organizations like API could not reasonably have been expected to attend a workshop on five to seven days notice at various sites located at great distances around the country with a consensus position representing a broad based input from its membership. There simply was inadequate time to poll memberships and inadequate detail in the September 22, 1997 proposal to allow for meaningful participation. These workshop sessions appear to have been structured more as a "form" purporting to get public comment and input then to produce a "substance" of well reasoned and knowledgeable comments. Because of the short notice and sketchy nature of the MMS proposal, these sessions have had limited value in achieving broad based producer and industry input on this issue of oil valuation.

What remains perfectly clear is that there is a market for oil at the lease itself. Whatever MMS ultimately proposes must recognize this lease market and the complexity and variety of lease market situations for federal oil production. Whether it is called posted price or by some other name, a value determined at the lease with appropriate and fair adjustments for quality, location and marketing cost must be included as part of the MMS proposal. A series of properly promulgated benchmarks may be the best way to address the variety and complexity of these valuation issues at the lease. The currently effective benchmarks might even be fine tuned for use. Shell is opposed to any scheme which is based on arbitrary distinctions, such as ownership of downstream refineries. There is no factual basis on which to rest a legal conclusion that the mere ownership of a refinery makes a valuation suspect.

Tendering program details in the MMS proposal were inadequate to present any real comments. For example, will the tender sale price be fixed? Will it float with some market indicator? Will the term be for thirty (30) days, six (6) months? What geographic locations would be covered by it? Filling in details such as these will allow realistic comments and evaluation of a tender program.

In promulgating benchmarks based on other parties (other than lessee purchase/sales), the MMS must consider the inability of a lessee to legally and timely acquire this information from third parties in order to make payment by the end of the month following the month of production. A basic flaw noted by Shell and other trade organizations in comments on the 1988 benchmarks was the legal unavailability of information on what unrelated third parties had received for sales and purchases of their oil in the same field or area. Only the MMS itself has this information based on the royalty reports filed by these parties. Even if the Freedom of Information restraints did not prevent disclosure of this information, the after the fact availability would make it impossible for a lessee to timely use this information as a payment option without duplicate estimated filings, with the potential impact of interest on overpayments or interest paid on underpayments.

MMS has proposed several alternatives for location differentials. A common theme running through them was a "fixed rate" based on different suggested elements. MMS transportation proposals deviated from a long established practice when it promulgated the 1988 valuation regulations. At this time, for non-arm's-length transportation, the MMS moved away from a previously accepted method of using the cost of comparable service paid by non-affiliated parties to move through the same distance on the same line for proprietary non-jurisdictional lines. MMS has always accepted tariffs as the appropriate rate on lines subject to FERC regulation. In 1988 and again now, MMS has proposed no justification for a utility type treatment which gives fixed, non-commercial rates for transport of its royalty portion which are not reflective of the true value of transportation provided. The solution to these situations is simple and is the same solution used by working interest owners to determine the value of transportation in their lines. First, tariffs should always be accepted on lines subject to federal or state to oversight by federal or state agencies. For arm's-length movement through proprietary non-jurisdictional lines, the arm's-length price paid is the right deduction for transportation. For proprietary, non-jurisdictional lines owned by a lessee who also owns the production, the lessee should be obligated to benchmark its transportation cost allowance against the cost paid by unrelated third parties to move through the same pipeline. MMS accepted this as an adequate cost allowance determination on proprietary lines prior to the 1988 regulations, and there is no reason why it could not be accepted today. It is reflective of actual cost of the reasonable actual cost to move the royalty product. Before MMS undertakes to promulgate some fixed approach providing it with a favored utility type status, MMS must produce a legal basis for this special treatment. At present, there simply is none. The IBLA has held from the very onset of its approach of transportation allowances (over DOI objection) that the royalty share must bear its share of reasonable transportation cost. These proposals for "fixed fees" are arbitrary and contrary to MMS's obligation under existing law and are overly complex. The royalty share should be obligated to bear its own fair share of cost in the same way that the working interest share bears its cost. The federal mineral lease is no more than an ordinary contract granting ordinary contractual rights which do not support specialized favored transportation treatment.

Shell requests that MMS respond in detail to the comments previously filed on its January, 1997 proposal. The agency should publish in greater detail proposals which will allow the public, including both the oil and gas industry as well as different trade organizations, to file particular and well thought out comments to assist the agency in promulgating new regulations. If public workshops are to be held, they should be noticed with sufficient time to meaningful attend and contribute. Shell appreciates the opportunity to file these comments.

Sincerely yours,

Peter Velez

Peter K. Velez
Regulatory Affairs Manager